

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Leach Analyst: Roger Lackey Bill Number: AB 19
Related Bills: See Prior Analysis Telephone: 845-3627 Amended Date: 3/4/99
Attorney: Doug Bramhall Sponsor: _____

SUBJECT: Minimum Tax Relief For Year of Cancellation/Dissolution

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED December 7, 1998, STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY OF BILL

This bill would provide that limited partnerships (LP), limited liability partnerships (LLP), limited liability companies (LLC), and corporations would pay only a percentage of their annual LP, LLP, or LLC tax and minimum franchise tax based on the months of the taxable or income year preceding the effective date of the cancellation, dissolution, or withdrawal.

SUMMARY OF AMENDMENT

The March 4, 1999, amendments eliminated the previous provisions of the bill providing for an exemption from the minimum franchise tax for corporations incorporated less than five years. Instead, the amendments would provide partial relief from the annual tax for the year of cancellation, dissolution, or withdrawal.

The Effective Date, Legislative History, Program History/Background and Specific Findings relating to the minimum franchise tax (other than provisions describing the bill) in department's analysis of AB 19 as introduced December 7, 1999, still apply. Additional state law discussion has been provided below, as well as new Policy, Implementation, and Technical Considerations, Departmental Costs, and Revenue.

SPECIFIC FINDINGS

Existing state law provides that every corporation incorporated in this state, qualified to transact intrastate business in this state or doing business in this state shall be subject to the minimum franchise tax from the earlier of the date of incorporation, qualification, or commencing to do business within this state, until the effective date of dissolution or withdrawal or, if later, the date the corporation ceases to do business within the state.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald Goldberg

3/22/1999

Existing state law requires that a corporation not exempted from taxation by state law that dissolves or withdraws shall pay a tax for its taxable year of dissolution or withdrawal according to or measured by its net income for the income year in which it ceased doing business, unless such income was previously included in the measure of tax for any taxable year of dissolution or withdrawal. The tax for the taxable year of the corporation's dissolution or withdrawal shall not be less than the minimum franchise tax required by state law.

Existing state law provides that prior to the dissolution of a corporation, the corporation must obtain a tax clearance certificate from the Franchise Tax Board (FTB) certifying that the taxes due, if any, for the dissolving corporation have been paid, assumed or guaranteed by bond or otherwise. Procedures vary depending on whether the dissolution is voluntary or involuntary. Existing state law also requires corporations to obtain a tax clearance certificate before the Secretary of State may accept a foreign corporation's certificate of surrender of its qualification to do business in this state. These requirements are also applicable to an LLC classified as a corporation for California tax purposes.

Existing state law also requires an LLC that is not classified as a corporation to obtain a tax clearance certificate from the FTB prior to the cancellation of the articles of organization of a California LLC or the cancellation of registration of a foreign LLC to conduct business in this state. The fee payable by an LLC not classified as a corporation is considered a tax for purposes of a tax clearance certificate.

In addition, newly enacted **state law** requires that the FTB notify limited partnerships (LPs) when they file a final return that the LP tax is due annually until a certificate of cancellation is filed with the Secretary of State (SOS).

This bill would provide that an LP, LLP, LLC, or a corporation would pay only a portion of the annual LP, LLP, or LLC tax or the minimum franchise tax based on the number of months in the taxable year prior to the effective date of cancellation, dissolution, or withdrawal.

This bill would provide that the tax be determined by ascertaining the ratio of the months of the taxable or income year preceding the effective date of cancellation, dissolution, or withdrawal, bear to the months of the taxable or income year.

Under current state law, LLCs also owe an annual fee based on the total income from all sources reportable to California in the taxable year. **This bill** would not affect the computation of the annual fee of a dissolving LLC. The fee is due and payable on the due date the return of the LLC.

Policy Considerations

This bill would not provide equal treatment to other entities that pay an annual tax of a fixed amount such as real estate mortgage investment conduits (REMICs), financial assets securitization investment trusts (FASITs), and qualified subchapter S subsidiaries (QSSSs).

Implementation Considerations

Current law (Section 23151.2 (a)) provides that a corporation in the year of dissolution or withdrawal shall pay a tax for the taxable year of an amount not less than the minimum franchise tax. This bill would insert a paragraph in that same section that would provide that a corporation could pay less than the minimum franchise tax in the income year of its dissolution or withdrawal. The conflicting provisions may confuse the taxpayer and the department regarding which amount the taxpayer should pay.

Current law requires corporations to make payments of estimated tax with the first installment of no less than the minimum franchise tax. Refunds would need to be made to business entities that pay the applicable tax prior to the end of the taxable or income year, but subsequently are dissolved or withdraw before the end of that taxable or income year. Issuing these refunds would create a minor additional workload for the department.

Technical Considerations

This bill amends a section of the B&CTL providing for the calculation of the tax for the taxable year of dissolution. Since all other affected B&CTL and PITL provisions reference the minimum franchise tax in Section 23153, attached Amendment 9 modifies and moves this provision to Section 23153 so that all other appropriate provisions will include the proration of the final year tax without amending each section.

This bill provides that for LLCs, LPs, and LLPs that dissolve or withdraw, the tax for the final year is prorated as specified. Dissolution of these entities is not equivalent to the dissolution of a corporation. The dissolution of a corporation ends the existence of a corporation as a legal entity. The dissolution of these other entities begins the process of ending the legal existence of these entities. The legal existence of these other entities ends with the cancellation of these entities with the Secretary of State. Furthermore, the date of dissolution for these entities generally precedes the date of the filing of the certificate that terminates the entities existence - a certificate of cancellation. Amendments 2, 4, 7, and 9 clarify the termination date of these entities. These same amendments also clarify that if the withdrawing foreign entity continues to do business, the tax for the final year is not prorated.

FISCAL IMPACT ON STATE BUDGET

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB 19 As Amended 3/7/99 [\$ In Millions]		
1999-00	2000-01	2001-02
(\$9)	(\$7)	(\$7)

The bill would be effective with income years beginning on or after January 1, 1999, with enactment assumed after June 30.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The number of specified corporate and non-corporate entities that dissolve or withdraw in any given year and owe a lesser amount of minimum tax than the currently required \$800 would determine the revenue impact of this bill.

The number of specified entities filing each year was projected by using an applicable growth rate for each entity type. According to departmental data, corporations terminate at a rate of approximately 3.5% annually (roughly 16,000 corporations). The rate of corporate terminations was used as a proxy to determine potential terminations of other entity types eligible for this tax benefit. The number of LPs, LLPs, and LLCs estimated to dissolve or withdraw in 1999, totals 2,700. Estimates assume an average mid-year termination date.

Each year the department issues roughly 16,000 tax clearance certificates. About 10%-20% of dissolving corporations pay a measured tax. Therefore, estimates assume that of the corporations dissolving in any given year, 85% pay only the minimum tax.

Board Position

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 19
As Amended March 4, 1999

AMENDMENT 1

On page 2, amend line 25 by adding at the end thereof the following:

The tax for the taxable year of cancellation shall be determined under subdivision (e).

AMENDMENT 2

On page 3, delete lines 15 through 23, inclusive and insert:

(e) If a certificate of cancellation has been filed on behalf of a limited partnership with the office of the Secretary of State pursuant to Section 15623 or 15696 of the Corporations Code, the tax imposed under subdivision (b) for the taxable year of cancellation shall be equal to the amount determined under paragraph (4) of subdivision (d) of Section 23153 for the taxable year of dissolution or withdrawal of a corporation as if the limited partnership were a corporation other than a qualified new corporation. For purposes of applying paragraph (4) of subdivision (d) of Section 23153, the effective date of a cancellation filed pursuant to Section 15623 or 15696 of the Corporations Code is the date the certificate of cancellation is filed on behalf of the limited partnership with the Secretary of State. This subdivision shall not apply to a limited partnership doing business in this state after the effective date of cancellation as provided in Section 15696 of the Corporations Code.

AMENDMENT 3

On page 3, line 24, after "SEC 2." insert:

Section 17941 of the Revenue and Taxation Code is amended to read:

17941. (a) For each taxable year beginning on or after January 1, 1997, every limited liability company doing business in this state (as defined in Section 23101) shall pay annually to this state a tax for the privilege of doing business in this state in an amount equal to the applicable amount specified in paragraph (1) of subdivision (d) of Section 23153 for the taxable year.

(b) In addition to any limited liability company which is doing business in this state and is therefore subject to the tax imposed by subdivision (a), for each taxable year beginning on or after January 1, 1997, a limited liability company shall pay annually the tax prescribed in subdivision (a) if articles of organization have been accepted, or a certificate of registration has been issued, by the office of the Secretary of State.

The tax shall be paid for each taxable year, or part thereof, until a certificate of cancellation of registration or of articles of organization is filed on behalf of the limited liability company with the office of the Secretary of State. The tax for the taxable year of cancellation shall be determined under subdivision (b) of Section 17946.

(c) The tax assessed under this section shall be due and payable on or before the 15th day of the fourth month of the taxable year.

(d) For purposes of this section, "limited liability company" means any organization that is formed by one or more persons under the law of this state, any other country, or any other state, as a "limited liability company" and that is not taxable as a corporation for California tax purposes.

SEC. 3.

AMENDMENT 4

On page 3, delete lines 26 through 40, inclusive, and insert:

17946. (a) A limited liability company shall not be subject to the taxes and fees imposed by this chapter if the limited liability company did no business in this state during the taxable year and the taxable year was 15 days or less.

(b) If a certificate of cancellation has been filed on behalf of a limited liability company with the office of the Secretary of State pursuant to Section 17356 or 17455 of the Corporations Code, the tax imposed under Section 17941 for the taxable year of cancellation shall be equal to the amount determined under paragraph (4) of subdivision (d) of Section 23153 for the taxable year of dissolution or withdrawal of a corporation as if the limited liability company were a corporation other than a qualified new corporation. For purposes of applying paragraph (4) of subdivision (d) of Section 23153, the effective date of a cancellation filed pursuant to Section 17356 or 17455 of the Corporations Code is the date the certificate of cancellation is filed on behalf of the limited liability company with the Secretary of State. This subdivision shall not apply to a limited liability company doing business in this state after the effective date of cancellation as provided in Section 17455 of the Corporations Code.

AMENDMENT 5

On page 4, before line 1, insert:

SEC. 4. Section 17948 of the Revenue and Taxation Code is amended to read:

17948. (a) For each taxable year beginning on or after January 1, 1997, every limited liability partnership doing business in this state (as defined in Section 23101) and required to file a return under Section 18633 shall pay annually to the Franchise Tax Board a tax for the privilege of doing business in this state in an amount equal to the applicable amount specified in paragraph (1) of subdivision (d) of Section 23153 for the taxable year.

(b)(1) In addition to any limited liability partnership that is doing business in this state and therefore is subject to the tax imposed by subdivision (a), for each taxable year beginning on or after January 1, 1997, every registered limited liability partnership that has registered with the Secretary of State pursuant to Section 15049 of the Corporations Code and every foreign limited liability partnership that has registered with the Secretary of State pursuant to Section

15055 of the Corporations Code shall pay annually the tax prescribed in subdivision (a). The tax shall be paid for each taxable year (other than the taxable year of cessation or withdrawal), or part thereof, until any of the following occurs:

(A) A notice of cessation is filed with the Secretary of State pursuant to subdivision (b) of Sections 15050 and 15056 of the Corporations Code.

(B) A foreign limited liability partnership withdraws its registration pursuant to subdivision (a) of Section 15056 of the Corporations Code.

(C) The registered limited liability partnership or foreign limited liability partnership has been dissolved and finally wound up.

(2) The tax of a limited liability partnership subject to tax under this subdivision for the taxable year of cessation or withdrawal shall be determined under subdivision (b) of Section 17948.2.

(c) The tax assessed under this section shall be due and payable on the date the return is required to be filed under Section 18633.

AMENDMENT 6

On page 4, line 1, delete "SEC. 3." and insert:

SEC. 5

AMENDMENT 7

On page 4, delete lines 9 through 19, inclusive, and insert:

(b) If a notice of cessation has been filed with the Secretary of State pursuant to subdivision (b) of Sections 15050 and 15056 of the Corporations Code or a foreign limited liability partnership has withdrawn its registration pursuant to subdivision (a) of Section 15056 of the Corporations Code, the tax imposed under Section 17948 for the taxable year of cessation or withdrawal shall be equal to the amount determined under paragraph (4) of subdivision (d) of Section 23153 for the taxable year of dissolution or withdrawal of a corporation as if the limited liability partnership were a corporation other than a qualified new corporation. For purposes of applying paragraph (4) of subdivision (d) of Section 23153, the effective date of a cessation or withdrawal filed pursuant to Section 15050 or 15056 of the Corporations Code is the date the notice of cessation or the withdrawal of registration is filed with the Secretary of State. This subdivision shall not apply to a limited liability partnership doing business in this state after the effective date of withdrawal of registration as provided in Section 15056 of the Corporations Code.

AMENDMENT 8

On page 4, delete lines 20 through 40, and on page 5, delete lines 1 through 4, inclusive.

AMENDMENT 9

On page 5, after line 4, insert:

SEC. 6. Section 23153 of the Revenue and Taxation Code is amended to read:

23153. (a) Every corporation described in subdivision (b) shall be subject to the minimum franchise tax specified in subdivision (d) from the earlier of the date of incorporation, qualification, or commencing to do business within this state, until the effective date of dissolution or withdrawal as provided in Section 23331 or, if later, the date the corporation ceases to do business within the limits of this state.

(b) Unless expressly exempted by this part or the California Constitution, subdivision (a) shall apply to each of the following:

(1) Every corporation that is incorporated under the laws of this state.

(2) Every corporation that is qualified to transact intrastate business in this state pursuant to Chapter 21 (commencing with Section 2100) of Division 1 of Title 1 of the Corporations Code.

(3) Every corporation that is doing business in this state.

(c) The following entities are not subject to the minimum franchise tax specified in this section:

(1) Credit unions.

(2) Nonprofit cooperative associations organized pursuant to Chapter 1 (commencing with Section 54001) of Division 20 of the Food and Agricultural Code that have been issued the certificate of the board of supervisors prepared pursuant to Section 54042 of the Food and Agricultural Code. The association shall be exempt from the minimum franchise tax for five consecutive income years, commencing with the first income year for which the certificate is issued pursuant to subdivision (b) of Section 54042 of the Food and Agricultural Code. This paragraph only applies to nonprofit cooperative associations organized on or after January 1, 1994.

(d) (1) Except as provided in ~~paragraph~~ paragraphs (2) and (4), corporations subject to the minimum franchise tax shall pay annually to the state a minimum franchise tax of eight hundred dollars (\$800).

(2) The minimum franchise tax shall be twenty-five dollars (\$25) for each of the following:

(A) A corporation formed under the laws of this state whose principal business when formed was gold mining, which is inactive and has not done business within the limits of the state since 1950.

(B) A corporation formed under the laws of this state whose principal business when formed was quicksilver mining, which is inactive and has not done business within the limits of the state since 1971, or has been inactive for a period of 24 consecutive months or more.

(3) For purposes of paragraph (2), a corporation shall not be considered to have done business if it engages in other than mining.

The minimum franchise tax for the taxable year of dissolution or withdrawal of a corporation or a qualified new corporation shall be the amount specified in paragraph (1) or subdivision (e), as applicable, for the taxable year during which dissolution or withdrawal occurs multiplied by a fraction the numerator of which shall be the number of months of the taxable year, up to and including the month of effective date of dissolution or withdrawal as provided in Section 23331, and the denominator of which shall be twelve. This paragraph shall not apply to a corporation doing business in this state after the effective date of withdrawal as provided in Section 23331.

(e) Notwithstanding subdivision (a), for income years beginning on or after January 1, 1999, every "qualified new corporation" shall pay annually to the state a minimum franchise tax of five hundred dollars (\$500) for the second taxable year. This subdivision shall apply to any corporation that is a qualified new corporation and is incorporated on or after January 1, 1999. (1) The

determination of the gross receipts of a corporation, for purposes of this subdivision, shall be made by including the gross receipts of each member of the commonly controlled group, as defined in Section 25105, of which the corporation is a member.

(2) "Gross receipts, less returns and allowances reportable to this state," means the sum of the gross receipts from the production of business income, as defined in subdivision (a) of Section 25120, and the gross receipts from the production of non business income, as defined in subdivision (d) of Section 25120.

(3) "Qualified new corporation" means a corporation that begins business operations at or after the time of its incorporation and that reasonably estimates that it will have gross receipts, less returns and allowances, reportable to this state for the income year of less than one million dollars (\$1,000,000). "Qualified new corporation" does not include any corporation that began business operations as a single proprietorship, a partnership, or any other form of business entity prior to its incorporation. This subdivision shall not apply to any corporation that reorganizes solely for the purpose of reducing its minimum franchise tax.

(4) This subdivision shall not apply to limited partnerships, as defined in Section 17935, limited liability companies, as defined in Section 17941, limited liability partnerships, as defined in Section 17948, charitable organizations, as described in Section 23703, regulated investment companies, as defined in Section 851 of the Internal Revenue Code, real estate investment trusts, as defined in Section 856 of the Internal Revenue Code, real estate mortgage investment conduits, as defined in Section 860D of the Internal Revenue Code, financial asset securitization investment trusts, as defined in Section 860L of the Internal Revenue Code, qualified Subchapter S subsidiaries, as defined in Section 1361(b)(3) of the Internal Revenue Code, or to the formation of any subsidiary corporation, to the extent applicable.

(5) For any income year beginning on or after January 1, 1999, if a corporation has paid five hundred dollars (\$500) for the second taxable year under this subdivision, but in its second taxable year, the corporation's gross receipts, as determined under paragraphs (1) and (2), exceed one million dollars (\$1,000,000), an additional tax in the amount equal to three hundred dollars (\$300) for the second taxable year shall be due and payable by the corporation on the due date of its return, without regard to extension, for that year.

(e) Notwithstanding subdivision (a), a domestic corporation, as defined in Section 167 of the Corporations Code, that files a certificate of dissolution in the office of the Secretary of State pursuant to subdivision (c) of Section 1905 of the Corporations Code and that does not thereafter do business shall not be subject to the minimum franchise tax for income years beginning on or after the date of that filing.

(g) The minimum franchise tax imposed by paragraph (1) of subdivision (d) shall not be increased by the Legislature by more than 10 percent during any calendar year.

AMENDMENT 10

On page 5, line 5, delete "SEC. 5." and insert:

SEC. 7